H&R REAL ESTATE INVESTMENT TRUST

# annual report 1999

HR
REIT

# H&R REAL ESTATE INVESTMENT TRUST

Incorporated on November 4, 1996, H&R Real Estate Investment Trust ("H&R REIT") owns and manages a portfolio of income-producing properties and provides mezzanine financing for development projects. As of December 31, 1999, H&R REIT held interests in 20 office properties, 38 single-tenant industrial properties, four retail properties and 12 development projects.

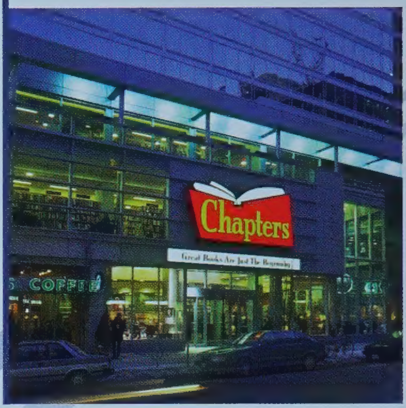
As a closed-end REIT, a substantial proportion of H&R REIT's cash is distributed to Unitholders each month and much of it is tax deferred.

The REIT's internal management conducts the day-to-day operations of H&R REIT at the direction of the Board of Trustees. Investments are governed by specific guidelines and are subject to the approval of the Trustees.

Units of the Trust trade on the Toronto Stock Exchange (Symbol: HR.UN).

**COVER**
Rendering of Bell Mobility Building
Eglinton Avenue East
and Creekbank Road
Mississauga, Ontario

110 Bloor Street West
Toronto, Ontario

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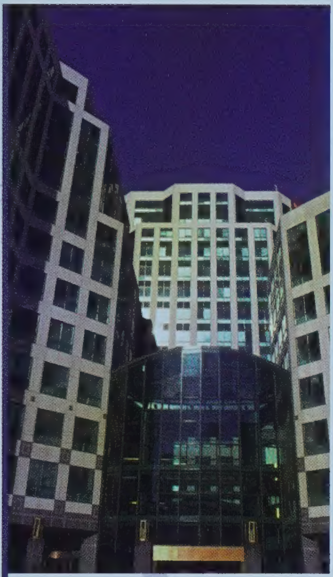


310-320-330 Front Street West
Toronto, Ontario

## HIGHLIGHTS

- The REIT acquired seven single-tenant industrial properties and one retail property, increasing gross leasable area by 35% to 9.1 million square feet.
- We provided $79.4 million in mezzanine financing for the development of five projects where the REIT can utilize is development expertise to achieve superior returns; the most prominent financing being for the development of Bell Mobility's new 465,000 square foot office complex in Mississauga, Ontario.
- A $220 million, 22-year, first mortgage bond was secured for the construction of TransCanada PipeLines' new Class A head office building.
- The REIT executed it's options to purchase one retail and two single-tenant industrial projects for which we had previously provided mezzanine financing.
- The cash distribution to Unitholders in 1999 totaled $1.104 per unit or $0.092 per month.
- H&R REIT was one of Canada's only REITs able to complete a unit offering in 1999, raising $70.2 million in July, 1999.





## OBJECTIVES

H&R Real Estate Investment Trust has two main objectives:

First, to provide Unitholders with reliable, growing and tax-deferred cash distributions from its portfolio of income producing properties and projects for which it provided mezzanine financing.

Second, to increase the value of units through active management of the REIT's assets and the acquisition of additional properties.

Management is committed to maximizing net earnings and capital appreciation while maintaining prudent risk management and conservative use of financial leverage.


10300 Henri Bourassa
St. Laurent, Québec

# REPORT TO UNITHOLDERS

## OVERVIEW

H&R REIT enjoyed another year of solid growth in 1999. We have accomplished this objective by continuing to focus on enhancing our portfolio, both through the addition of high quality, well-leased properties and through the provision of mezzanine financing for development projects, which together produce a secure and increasing stream of cash flow.

Our operating philosophy is a reflection of this focus. We lease our buildings to highly creditworthy tenants, under long-term leases with contractual rental escalations; and we provide mezzanine financing for development projects that meet our strict investment criteria, enabling us to achieve enhanced returns with minimized risk during the development cycle.

The pace of change in the North American economy is unprecedented and we are adapting our portfolio in light of these ongoing changes. Our portfolio is evolving in step with the new economy, positioning H&R REIT securely to continue its record of success.



## FINANCIAL RESULTS

H&R REIT achieved new highs in its 1999 financial results, despite operating in a capital markets environment that was not favourable for the real estate industry. Revenue, cash flow from operations and distributable income all increased significantly during the year, both in absolute and per unit terms, leading to higher cash distributions to Unitholders.

Operating revenue increased 34% to $136.1 million, the result of accretive acquisitions, income from mezzanine financing projects and contractual rent increases across the portfolio. This compares very positively with only a 29% increase in combined operating and trust expenses, and resulted in improved cash flow and distributable income.

Cash flow from operations increased 42% to $54.1 million, while distributable income rose 44% to $51.7 million. On a per unit basis, cash flow from operations increased 7% to $1.30 per unit while distributable income was ahead 8% to $1.24 per unit. Cash distributions to Unitholders increased 7% to $1.104 per unit, representing an 89% payout of distributable income, which percentage is amongst the lowest in the industry and in line with H&R REIT's historical 90% payout philosophy.

In July 1999, H&R REIT issued 6,325,000 new trust units at a price of $11.10 per unit, raising total proceeds of $70,207,500. The REIT continues to invest in mezzanine financings and acquisitions that provide a return above the portfolio's average rate of return, ensuring that new unit offerings are accretive for existing Unitholders. H&R REIT's ability to access public markets in 1999 differentiated us from most others in the real estate sector for whom the equity markets were not available.

## PORTFOLIO REVIEW

In 1999, H&R REIT continued to expand its property portfolio, both through the acquisition of existing high-quality properties leased to long-term creditworthy tenants as well as through the provision of mezzanine financing to strategic development projects. The REIT's investment program in 1999 was focused more on the latter class of properties as the returns were consistently higher.

## INCOME PRODUCING PROPERTIES

At year-end 1999, H&R REIT had $687.4 million invested in income producing properties, an increase of 17% from 1998 levels. The increase was the result of both new property acquisitions and the exercise of REIT-held options to acquire properties that had been the subject of mezzanine financing provided by H&R REIT in earlier periods.

In July, we announced the investment of $33.1 million to acquire two important properties in Boucherville, Québec, both with excellent tenants, leased on a long-term basis and both with the capability to allow the tenants to expand.

First, we acquired a recently completed 729,000 square foot single-tenant industrial distribution warehouse for $27 million. The property is situated on a 52.8 acre site and is leased to Rona Inc. under a 20-year term with contractual rent escalations throughout the term. We are earning a 14.5% return on this property.

Rendering of TransCanada PipeLines Tower Calgary, Alberta

Second, we invested $6.1 million to acquire a 140,000 square foot single-tenant industrial building on a 15-acre site. This property is leased to Corporate Express for 15 years, features contractual rent escalations and is earning an initial return in excess of 15% for the REIT.

The REIT also acquired two other single-tenant industrial properties. The first is a 164,000 square foot building in Mississauga, Ontario which the REIT purchased for $7.9 million and is leased for 20 years to Servi-Logistix. The second is a 742,000 square foot property in Montreal, acquired for $20.5 million and leased to Consumers Packaging for 15 years. The REIT is earning a return in excess of 15% on these two investments.

We also exercised options to acquire properties for which we previously provided mezzanine financing.

In December, we announced that H&R REIT had exercised its option to acquire a 50% interest in the initial two phases of the Shawnessy Towne Centre development project in Calgary. The project is a 66.4 acre retail centre that will comprise 295,000 square feet on completion and includes Business Depot, Michael's and Future Shop as tenants. The REIT expects to earn a leveraged return of approximately 18% after our option is exercised on all phases of the project.

In addition, the REIT exercised its options on two other developments. The first, for $5.1 million, was to acquire a 69,000 square foot single-tenant industrial building in Mississauga, leased to Winston Steel for 15 years. The REIT is earning a 13.8% return on this investment. The second was for two newly constructed, state-of-the-art distribution facilities in Mississauga, Ontario totalling 475,000 square feet. With permanent financing now in place, the REIT is earning a 16.3% return on its $8 million equity investment.

The table beginning on page eight of this report highlights our existing portfolio of income producing properties, comprising office, single-tenant industrial and retail. Our philosophy in acquiring projects is the same regardless of the asset class. H&R REIT will only acquire quality assets occupied by creditworthy tenants signed to long-term leases with built-in rent escalations.





## MEZZANINE FINANCING FOR DEVELOPMENT

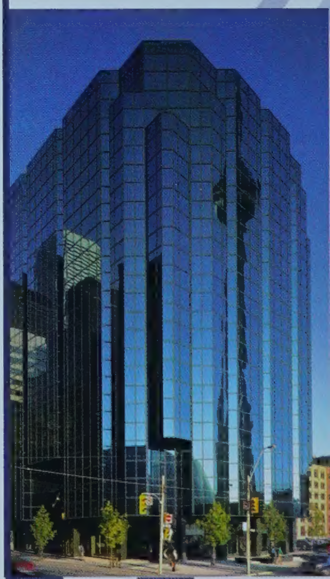
At year-end 1999, H&R REIT had $232.5 million invested as mezzanine financing for development projects. This represents an increase of 52% from 1998 levels. The REIT follows a highly disciplined strategy in pursuing these investments. Before advancing any funds to finance project construction, the property must be at least 70% pre-leased to companies meeting our demanding tenant profile. In addition, the REIT must have an option to purchase the property, at cost or at a predetermined yield, on completion of construction. By following this strategy, H&R REIT has been successful in earning returns superior to those otherwise available.

In 1999, we completed a number of important mezzanine financing transactions. In July, we announced the provision of approximately $28.0 million for the construction of 11 design-build facilities for Purolator Courier across Canada. The properties are being leased to Purolator for a 20-year term. This transaction is generating a 12% return during the period of mezzanine financing, increasing to approximately 14% once fully leveraged and our purchase option is exercised. The total land to be acquired will be 75 acres with total building size comprising 941,000 square feet.

At the same time, we announced the provision of $7.2 million for a 162,000 square foot single-tenant industrial property located in Mississauga and leased to PALEX Inc. for a 15-year lease term. The property is generating a 12% return during the period of mezzanine financing, increasing to 13.7% when the building is occupied and fully financed.

Subsequent to year-end, the REIT continued to execute its strategy of exercising its option to acquire projects for which it provided mezzanine financing. By the end of March 2000, the REIT had closed on two distribution centres leased to Purolator Courier and was in the midst of closing three additional Purolator properties. In addition, the REIT had given notice to exercise its option on the property leased to PALEX Inc. and on the 50% interest in the Shawnessy Town Centre's second and third site.

145 Wellington Street West
Toronto, Ontario



Work continued on our landmark TransCanada PipeLines Tower project. In October, it was announced that H&R Developments Corporation arranged for a $220 million, 22-year, first mortgage bond financing for the 936,000 square foot, Class A head office

building, currently under construction in downtown Calgary. H&R REIT was providing approximately $43.1 million of mezzanine financing for the project at December 31, 1999 and holds an option to purchase the building upon completion at cost, expected to be approximately $260.0 million. Construction is well underway with the formwork now completed for the 30th floor of the 36-storey tower. Occupancy is scheduled for June 2001 and we expect to earn a return of approximately 17% for the REIT on exercise of the option.

In October, we announced the provision of up to $35.0 million in mezzanine financing for the development of a 465,000 square foot office complex in Mississauga, Ontario, fully leased to Bell Mobility for a term of 18 years with contractual rental increases every five years. The total cost of the project is expected to be $110.0 million. The REIT expects to generate an unleveraged cash-on-cash return in excess of 9.6% for the first five years of the lease term, which will increase significantly after appropriate long-term fixed rate financing is secured. Completion of the complex is scheduled for the summer of 2001.

As with Purolator, this project is another example of H&R REIT participating in the new economy. The leading-edge campus facility will utilize the latest wireless communications technology and will comprise scalable and adaptable floor plates and additional land for expansion providing Bell Mobility with the flexibility it requires to continue its growth well into the future.

## MARKET OVERVIEW

Real estate fundamentals remain strong in all of our asset classes. In the office sector, total vacancy rates at year-end were 7.8% in the key GTA market, down from 8.1% a year ago. Importantly, some tenant reaction to high downtown rents had the effect of pushing demand to suburban locations, where H&R REIT is well positioned. Absorption rates are roughly equivalent to supply increases, suggesting a stable market.

In the industrial sector, the GTA vacancy rate was 4.7% at year-end 1999 compared to 4.9% a year earlier, despite considerable new supply in the single-tenant market. Strong economic activity contributed to the high absorption rate, a trend expected to continue in 2000. In the retail sector, the market continues to be characterized by strong consumer spending, leading to healthy markets for H&R REIT's downtown Toronto property and our power centre locations in other regions. Across the portfolio, the REIT's occupancy rate at the end of 1999 was 99%, a rate better than the industry norm.

## STRATEGY

Our core operating strategy has not changed since the inception of the REIT in 1996 and applies to all asset classes. Whether through acquisition or the exercise of options on development projects, we acquire properties with long-term leases to quality tenants, and built-in cash flow increases. The REIT acquires properties below replacement cost and enhances returns through the mezzanine financing program. To reduce risk, management has attempted to closely match the weighted average term to maturity of the mortgages, being 9.4 years, to the remaining average lease term of 10.1 years. H&R REIT's Trust Indenture limits long-term debt to a maximum of 60% of gross book value of assets, and we completed 1999 at the 48% level.

H&R REIT is focused on delivering Unitholder value and doing so without dilution to existing Unitholders. In that context, the REIT recently introduced a Unitholder Distribution Reinvestment Plan and a Unit Purchase Plan. These plans provide Unitholders with an opportunity to purchase additional units at a discount to market without incurring brokerage fees.

As we continue to build H&R REIT's portfolio, we remain mindful of the changes in our economy and how these changes have altered the dynamics of the real estate industry. Our focus will be on acquiring properties that are leased to companies participating and thriving in the new economy. We already have an excellent base of such tenants, with telecommunications companies in our office sector, logistics and distribution companies in our single-tenant industrial sector and big box stores in our retail sector; tenants include Nortel Networks, Livingston Logistics, Motorola, Telerate Canada, Telus, Servi-Logistix, TCT Logistics, Livingston Distribution Centres and Dicom Express. We will continue to pursue opportunities on this strategic basis.

## OUTLOOK

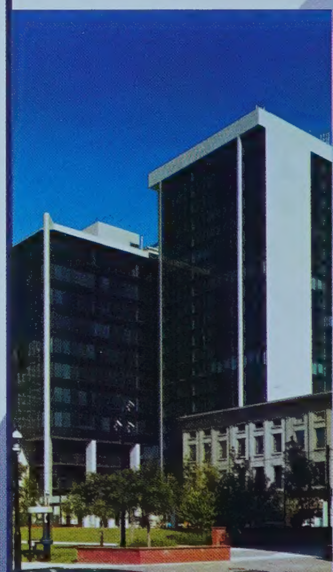
H&R REIT is well positioned in the new economy marketplace. The economy in our key markets remains strong and real estate fundamentals are sound.

Management expects 2000 to be a solid year for H&R REIT. We will continue to benefit from increasing rents in our existing portfolio and the acquisition of new properties, either through purchases of existing buildings or the exercise of mezzanine financing options. Looking further out, growth should accelerate as H&R REIT begins to benefit from large-scale development investments including the TransCanada PipeLines Tower and the Bell Mobility project.

As always, management is indebted to the Board of Trustees and our employees, whose dedication and hard work are responsible for the sustained growth of H&R REIT. We also recognize our tenants and Unitholders whose support is critical to our continued success.

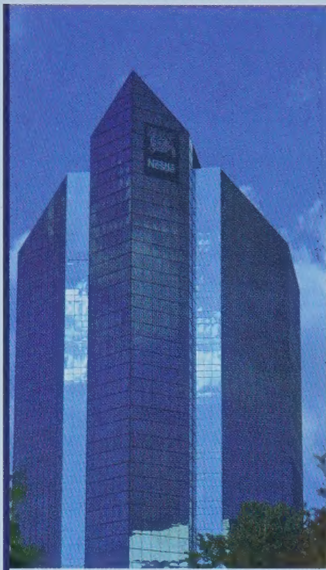
Thomas J. Hofstedter
President and Chief Executive Officer

26 Wellington Street East
Toronto, Ontario



88 McNabb Street
Markham, Ontario

2767-2nd Avenue
Calgary, Alberta

25 Sheppard Avenue West
North York, Ontario

Shawnessy Towne Centre (Site 1)
Calgary, Alberta


631 South Olive Street
Los Angeles, California

250 University Avenue
Toronto, Ontario


11 Kenview Boulevard
Brampton, Ontario

## OFFICE PROPERTIES

As at December 31, 1999

| Properties | Ownership Interest | Year Built | Net Rentable Area (Square Feet) | Occupancy | Major Tenants | Occupancy by Major Tenants |
|---|---|---|---|---|---|---|
| 310-320-330 Front St. West<br>Toronto, Ontario | 70% | 1989-1990 | 567,861 | 96% | Galileo Canada, National Bank, Royal Bank of Canada, Lumberman's Mutual, NCR | 70% |
| 401-405 The West Mall<br>Etobicoke, Ontario | 70% | 1983-1985 | 410,784 | 100% | Livingston International, Parmalat Foods, Royal Insurance, Best Foods, Gilbey Canada, Etobicoke Community Care Access Centre | 62% |
| 25 Sheppard Avenue West<br>North York, Ontario | 70% | 1994 | 359,227 | 100% | Nestlé Canada, Telemedia, Hewitt & Associates, Association of Professional Engineers of Ontario | 87% |
| 26 Wellington Street East<br>Toronto, Ontario | 70% | 1981 | 172,353 | 99% | Sun Life of Canada, United Way, Sceptre Investments | 62% |
| 55 Yonge Street<br>Toronto, Ontario | 70% | 1956 | 154,890 | 100% | CIBC, Telerate Canada, TransCanada PipeLines, TransCanada Gas Marketing, BPI Financial | 87% |
| 145 Wellington Street West<br>Toronto, Ontario | 70% | 1987 | 153,314 | 98% | American International Group, Aon Consulting | 78% |
| 110 Sheppard Avenue East<br>North York, Ontario | 50% | 1993 | 145,116 | 100% | Equifax Canada Inc., Wyeth-Ayerst Canada Inc. | 97% |
| 2810 Matheson Blvd. East<br>Mississauga, Ontario | 35% | 1990 | 140,210 | 100% | Credit Union Central of Ontario, TTI Travel | 77% |
| 250 University Avenue<br>Toronto, Ontario | 100% | 1958 | 132,000 | 100% | King's Health Centre Corp. | 100% |
| 2780-2800 Skymark Avenue<br>Mississauga, Ontario | 60% | 1988-1990 | 109,018 | 100% | Starber-Fritz Inc., Nordic Tours, CIBC, McDonald's | 33% |
| 2611-3rd Avenue<br>Calgary, Alberta | 50% | 1998 | 95,465 | 100% | Telus Advertising Services Inc. | 100% |
| 631 South Olive Street*<br>Los Angeles, California | 100% | 1986 | 91,611 | 93% | The NBBJ Group, M.K. Diamonds | 17% |
| 1235 Bay Street<br>Toronto, Ontario | 100% | 1973 | 91,108 | 96% | Dental Anesthesia Assoc., Interac Business Centres, Walt Disney (Canada) Ltd. | 35% |
| 69 Yonge Street<br>Toronto, Ontario | 70% | 1914 | 85,151 | 100% | Livingston Group, Shoppers Drug Mart | 31% |
| 1 Kenview Boulevard<br>Brampton, Ontario | 100% | 1989 | 79,005 | 100% | Atlantis Aerospace Corp. | 100% |
| 291-295 The West Mall<br>Etobicoke, Ontario | 70% | 1978 | 77,345 | 88% | Parmalat Food, Investors Group Financial Services | 37% |
| 3625 Dufferin Street<br>North York, Ontario | 70% | 1965 | 71,288 | 86% | H&R Property Management Ltd. | 32% |
| 88 McNabb Street<br>Markham, Ontario | 70% | 1987 | 69,865 | 100% | Wyeth-Ayerst Canada Inc. | 100% |
| 2767-2nd Avenue<br>Calgary, Alberta | 100% | 1998 | 69,630 | 100% | DeVry Inc. | 100% |
| 131 McNabb Street<br>Markham, Ontario | 100% | 1989 | 54,100 | 100% | Drug Trading Company Ltd. | 100% |
| Total | | | 3,129,341 | 99% | | |

* Held through a wholly-owned U.S. subsidiary.

## SINGLE-TENANT INDUSTRIAL PROPERTIES

As at December 31, 1999

| Properties | Ownership Interest | Year Built-Renovated | Net Rentable Area (Square Feet) | Occupancy | Major Tenants | Occupancy by Major Tenants |
|---|---|---|---|---|---|---|
| 2300 Rue Senkus<br>LaSalle, Québec | 100% | 1972 | 742,000 | 100% | Consumers Packaging Inc. | 100% |
| 220 Chemin du Tremblay<br>Boucherville, Québec | 100% | 1999 | 729,000 | 100% | Rona Inc. | 100% |
| 55 West Drive<br>Brampton, Ontario | 100% | 1969-1981 | 505,565 | 100% | Winners Apparel Ltd. | 100% |
| 4441-76th Street<br>Calgary, Alberta | 100% | 1980 | 323,796 | 100% | TCT Logistics Inc., Livingston Distribution Centres Inc. | 100% |
| 137 Horner Avenue<br>Etobicoke, Ontario | 100% | 1962 | 320,000 | 100% | TCT Logistics Inc. | 100% |
| 2121 Cornwall Road<br>Oakville, Ontario | 100% | 1997-1998 | 314,165 | 100% | Livingston Logistics Services Inc. | 100% |
| 1600 Lionell Boulet<br>Varennes, Québec | 100% | 1971 | 311,103 | 100% | ASEA Brown Boveri Inc. | 100% |
| 1450 Mountain Avenue<br>Winnipeg, Manitoba | 100% | 1973 | 266,102 | 100% | Palliser Furniture | 100% |
| 7830 Tranmere Drive<br>Mississauga, Ontario | 100% | 1985-1987 | 265,469 | 100% | Paperboard Industries Corp. | 100% |
| 6580 Millcreek Drive<br>Mississauga, Ontario | 100% | 1999 | 249,634 | 100% | Livingston Contract Logistics Inc. | 100% |
| 75 Frontenac Drive<br>Markham, Ontario | 100% | 1986 | 247,556 | 100% | Hyundai Auto Canada | 100% |
| 6590 Millcreek Drive<br>Mississauga, Ontario | 100% | 1999 | 225,694 | 100% | NFC Canada Ltd. | 100% |
| 3655 Weston Road<br>Downsview, Ontario | 100% | 1970 | 184,266 | 100% | O.S.F. Inc. | 100% |
| 2390 Argentia Road<br>Mississauga, Ontario | 100% | 1984 | 179,085 | 100% | Northern Telecom Ltd. | 100% |
| 6660 Financial Drive<br>Mississauga, Ontario | 100% | 1998-1999 | 164,116 | 100% | Servi-Logistics Inc. | 100% |
| 351 Passmore Avenue<br>Scarborough, Ontario | 100% | 1986 | 161,137 | 100% | Slater Steel Inc. | 100% |
| 1616 Eiffel Street<br>Boucherville, Québec | 100% | 1989 | 139,978 | 100% | Corporate Express Canada Inc. | 100% |
| 11 Kenview Boulevard<br>Brampton, Ontario | 100% | 1989 | 139,548 | 100% | Para Paints Canada Inc. | 100% |
| 10920 178th Street<br>Edmonton, Alberta | 100% | 1987 | 131,475 | 100% | TCT Logistics Inc. | 100% |
| 2841 Langstaff Road<br>Vaughan, Ontario | 100% | 1996 | 123,906 | 100% | All Metal Machine Specialties Ltd., Planet Paper Box Inc. | 100% |
| 1350-1380 Matheson Boulevard East and 5391 Ambler Drive<br>Mississauga, Ontario | 100% | 1987 | 110,059 | 100% | Minuk Construction and Engineering | 100% |
| 10300 Henri Bourassa<br>St. Laurent, Québec | 100% | 1976-1989 | 81,500 | 100% | ASEA Brown Boveri Inc. | 100% |
| 2 East Beaver Creek Road<br>Richmond Hill, Ontario | 70% | 1988 | 78,982 | 100% | Country Style Donuts, Minacs World Wide Inc., Pureco Labs, Motorola | 100% |
| 360 Spinnaker Way<br>Vaughan, Ontario | 70% | 1995 | 41,944 | 100% | The Packaging Group | 100% |

## SINGLE-TENANT INDUSTRIAL PROPERTIES (continued)

| Properties | Ownership Interest | Year Built-Renovated | Net Rentable Area (Square Feet) | Occupancy | Major Tenants | Occupancy by Major Tenants |
|---|---|---|---|---|---|---|
| 6315 Kenway Drive<br>Mississauga, Ontario | 100% | 1998-1999 | 68,678 | 100% | Winston Steel Inc. | 100% |
| 1060 Tristar Drive<br>Mississauga, Ontario | 100% | 1984 | 65,284 | 100% | Clarke Lithographing Ltd. | 100% |
| 880 Milner Avenue<br>Scarborough, Ontario | 70% | 1990 | 60,028 | 100% | House of Electrical, G.H. Import | 100% |
| 2860 Plymouth Drive<br>Oakville, Ontario | 100% | 1989 | 59,613 | 100% | Garlock of Canada | 100% |
| 1 Moyal Court<br>Vaughan, Ontario | 70% | 1991 | 52,792 | 100% | Wajax Motion Technologies | 100% |
| 5 Bodrington Court<br>Markham, Ontario | 70% | 1994 | 50,000 | 100% | Belmont Press | 100% |
| [illegible]15 Matheson Blvd. East<br>Mississauga, Ontario | 70% | 1987 | 40,000 | 100% | ADT Security Services | 100% |
| [illegible] Spinnaker Way<br>[illegible]ghan, Ontario | 70% | 1995 | 33,017 | 100% | Topax Export Packaging | 100% |
| [illegible]3 14th Avenue<br>[illegible]rkham, Ontario | 70% | 1994 | 32,708 | 100% | Linsey Foods Limited | 100% |
| [illegible]00 Biscayne Crescent<br>[illegible]mpton, Ontario | 70% | 1996 | 31,606 | 100% | Dicom Express Inc. | 100% |
| [illegible]Bodrington Court<br>[illegible]ham, Ontario | 70% | 1992 | 28,089 | 100% | Corporate Foods Limited | 100% |
| [illegible]5 Addiscott Road<br>[illegible]am, Ontario | 70% | 1996 | 27,627 | 100% | Riviera Catering | 100% |
| [illegible]00 Matheson Blvd. East<br>[illegible]ssissauga, Ontario | 70% | 1993 | 25,000 | 100% | Givaudan Roure | 100% |
| 5230 Orbitor Drive<br>[illegible]sissauga, Ontario | 70% | 1994 | 22,000 | 100% | W.K. Buckley Limited | 100% |
| Total | | | 6,632,522 | 100% | | |

## RETAIL PROPERTIES

As at December 31, 1999

| Properties | Ownership Interest | Year Built | Net Rentable Area (Square Feet) | Occupancy | Major Tenants | Occupancy by Major Tenants |
|---|---|---|---|---|---|---|
| 720 Maloney Blvd. West<br>Gatineau, Québec | 50% | 1995-1998 | 279,242 | 100% | Wal-Mart, Canadian Tire, Metro Richlieu | 93% |
| 220 Chain Lake Drive<br>Halifax, Nova Scotia | 50% | 1996-1998 | 135,453 | 100% | Wal-Mart | 98% |
| Shawnessy Towne Centre (Site 1)<br>Calgary, Alberta | 50% | 1998-1999 | 150,120 | 100% | Business Depot, Michael's of Canada, Future Shop, Linens 'N Things, Towne Shoes, Mark's Work Warehouse | 85% |
| 110 Bloor Street West<br>Toronto, Ontario | 100% | 1997-1998 | 85,176 | 100% | Chapters, Nike, Escada, Louis Vuitton | 97% |
| Total | | | 649,991 | 100% | | |

## MEZZANINE FINANCING FOR DEVELOPMENT

As at December 31, 1999

| Properties | Property Type | Ownership Option | Expected Completion | Net Rentable Area (Square Feet) | Occupancy | Major Tenants |
|---|---|---|---|---|---|---|
| Purolator Distribution Centres<br>11 locations across Canada | Single-tenant industrial | 100% | December 2000 | 941,000 | 100% | Purolator Courier Ltd. |
| 125-4th Avenue S.W. and 120-5th Avenue S.W.<br>Calgary, Alberta | Office | 100% | June 2001 | 936,000 | 100% | TransCanada PipeLines |
| Eglinton Avenue East and Creekbank Road<br>Mississauga, Ontario | Office | 100% | September 2001 | 465,000 | 100% | Bell Mobility |
| 400 South Arkard Street<br>Dallas, Texas | Telecom use | 100% | June 2001 | 260,000 | 38% | First World, Williams |
| 7500 Lundy's Lane<br>Niagara Falls, Ontario | Retail | 100% | August 2000 | 173,000 | 71%* | Tommy Hilfiger, Guess, Levi's, Polo Ralph Lauren, Nike |
| 1330 Martingrove Road<br>Mississauga, Ontario | Single-tenant industrial | 100% | April 2000 | 162,000 | 100% | PALEX Inc. |
| 162nd and Shawville Blvd. (Site 2 & 3)<br>Calgary, Alberta | Retail | 50% | April 2000 | 145,000 | 93% | Petland, Pier 1 Imports, Alberta Treasury, Winners, Shoppers Drug Mart, CIBC, Reitman's |
| Front St. West and John St.<br>Toronto, Ontario | Office | 100% | N/A | N/A | N/A | N/A |
| Eglinton Avenue East and Creekbank Road<br>Mississauga, Ontario | Industrial/ Office | 100% | N/A | N/A | N/A | N/A |
| Derry Road and HWY 10<br>Mississauga, Ontario | Single-tenant industrial | 100% | N/A | N/A | N/A | N/A |
| Millcreek Drive<br>Mississauga, Ontario | Single-tenant industrial | 100% | N/A | N/A | N/A | N/A |
| 101 Edgeley Boulevard<br>Vaughan, Ontario | Retail | 50% | N/A | N/A | 100% (Wal-Mart only) | Wal-Mart |
| Total | | | | 3,082,000 | | |

* Phase 1 and 2 are completed and 100% occupied. Phase 3 is scheduled to be completed in August 2000.

## OVERVIEW OF PORTFOLIO

The following table summarizes the Portfolio of the REIT as at December 31, 1999.
[Net ownership position]

| Portfolio | Office | Single-Tenant Industrial | Retail | Total |
|---|---|---|---|---|
| Number of Properties | 20 | 38 | 4 | 62 |
| Total Leasable Area (square feet) | 2,248,585 | 6,475,384 | 367,584 | 9,091,553 |
| Occupancy* | 99% | 100% | 100% | 99% |
| Average Rent in Place | $ 15.39 | $ 4.23 | $ 18.53 | $ 7.56 |
| Average Interest Rate on Outstanding Mortgages* | 9.6% | 7.0% | 7.3% | 8.4% |

* Weighted Average

## LEASE MATURITIES

| Portfolio | Office* | Single-Tenant Industrial* | Retail* | Total* |
|---|---|---|---|---|
| 2000 | 1.1% | 0.1% | – | 1.2% |
| 2001 | 1.5% | 0.6% | – | 2.1% |
| 2002 | 2.9% | 4.6% | – | 7.5% |
| 2003 | 2.4% | 3.7% | 0.1% | 6.2% |
| 2004 | 3.1% | 3.2% | – | 6.3% |

* Percent of total leasable area of portfolio.

## DEBT MATURITIES

The following table summarizes the debt maturities for the properties of the REIT on a combined basis, exclusive of normal monthly self-amortizing principal repayments.

(In thousands of dollars)

| Portfolio | Office | Single-Tenant Industrial | Retail | Total | Percentage of Mortgages Outstanding |
|---|---|---|---|---|---|
| 2000 | $ – | $ 8,356 | $ – | $ 8,356 | 2.3% |
| 2001 | 32,782 | 2,077 | 9,400 | 44,259 | 12.3% |
| 2002 | – | 7,651 | – | 7,651 | 2.1% |
| 2003 | – | 1,811 | – | 1,811 | 0.5% |
| 2004 | 4,128 | 12,185 | – | 16,313 | 4.6% |

2780-2800 Skymark Avenue
Mississauga, Ontario

2810 Matheson Boulevard East
Mississauga, Ontario

220 Chemin du Tremblay
Boucherville, Québec

110 Sheppard Avenue East
North York, Ontario

2611-3rd Avenue
Calgary, Alberta

## OVERVIEW

H&R Real Estate Investment Trust (the "REIT") is an unincorporated closed-end trust created by a Declaration of Trust and governed by the laws of the Province of Ontario.

The REIT commenced operations on December 23, 1996 with the initial acquisition of a 70% undivided interest in a portfolio of 27 properties principally located in the Greater Toronto Area. As at December 31, 1999, the REIT owned and operated a portfolio of 62 properties (20 office, 38 single-tenant industrial, four retail) comprising an aggregate leaseable area of 9.1 million square feet (as calculated at the REIT's level of ownership) and had invested $232.5 million as mezzanine financing for 12 development projects.

The REIT's portfolio falls into the following geographic regions: three single-tenant industrial properties, two office properties, one retail property and two development projects are located in Western Canada; five single-tenant industrial properties and two retail properties are located in Eastern Canada, one office property is located in Los Angeles, California and one development project is located in Dallas, Texas; the Purolator Courier project consists of 11 sites across Canada and the balance of the properties and development projects are located in the Greater Toronto Area.

The REIT's primary objectives are to provide Unitholders with stable and growing cash distributions and to maximize unit value through ongoing active management of the REIT's assets, future acquisitions of additional properties and the provision of mezzanine financing for selected development projects.

## NET EARNINGS AND FINANCIAL POSITION

The financial information as at December 31, 1999 and the results of operations for the year then ended are presented in accordance with Canadian generally accepted accounting principles applicable to real estate investment trusts. The following discussion should be read in conjunction with the REIT's financial statements for the years ended December 31, 1999 and 1998.

## RESULTS OF OPERATIONS

Net earnings for the year ended December 31, 1999 of $48.3 million, or $1.16 per unit, increased by 41.7% on a dollar basis and 6.5% on a per unit basis over the $34.1 million, $1.09 per unit, for December 31, 1998. Depreciation of $5.2 million (1998 – $3.8 million) and amortization of $1.1 million (1998 – $0.5 million) are included in the determination of net income. The REIT does not consider depreciation expense when calculating distributions paid to Unitholders.

**Income from Rental Operations Before Depreciation and Amortization**

(In thousands of dollars)

| | 1999 | 1998 |
|---|---|---|
| Rentals from income properties | $ 115,882 | $ 93,432 |
| Mortgage interest income and other | 20,209 | 8,129 |
| | 136,091 | 101,561 |
| Property operating costs | 47,028 | 38,141 |
| Operating income before interest | 89,063 | 63,420 |
| Mortgage and other interest | 31,333 | 21,939 |
| Income from operations before depreciation and amortization | $ 57,730 | $ 41,481 |

## RENTALS FROM INCOME PROPERTIES

Rental income from income properties increased 24.0% from $93.4 million to $115.9 million in 1999. The increase is primarily a result of the REIT's ongoing acquisition program that totaled $107.3 million in 1999. Property operating costs and mortgage and other interest have also increased from $38.1 million and $21.9 million, to $47.0 million and $31.3 million respectively in 1999.

The 99% occupancy rate in the REIT's portfolio at December 31, 1999 remained above the industry average for the second consecutive year. The exposure to lease rollovers, as a result of lease expiries over the next five years (as a percentage of the REIT owned leasable area of the properties) is as follows:

| | |
|---|---|
| 2000 | 1.2% |
| 2001 | 2.1% |
| 2002 | 7.5% |
| 2003 | 6.2% |
| 2004 | 6.3% |

## MORTGAGE INTEREST INCOME

The REIT earned $20.2 million in mortgage interest income in 1999 compared to $8.1 million in 1998. This increase further reflects the REIT's policy of providing mezzanine financing for development projects as an integral part of the REIT's operations. Included in this amount is $6.3 million earned from the mezzanine financing for the TransCanada PipeLines Tower project, the largest single transaction in the REIT's history. The weighted average interest rate earned on these investments in 1999 was approximately 10.9%. For details on mortgage receivable activity in the year, see Mortgages Receivable.

## SALE OF INCOME PROPERTIES

The REIT will dispose of non-strategic assets that no longer fit its investment strategy and redeploy those proceeds in better investment opportunities. In 1999, the REIT sold a single-tenant industrial property in Mississauga, Ontario, which was part of its original portfolio, realizing proceeds on disposition of $1.4 million.

## TRUST EXPENSES

Trust expenses remained constant during the year at $3.1 million despite the increase in revenue. These expenses amount to 2.7% of rentals from income properties, a reduction from 3.1% in 1998, a percentage that is among the lowest in the Canadian real estate industry.

## DISTRIBUTION TO UNITHOLDERS

The policy of the REIT is to distribute approximately 90% of its distributable income to Unitholders on a monthly basis. Depreciation and other non-cash items are added to, or deducted from, net earnings to determine the amount of income for distribution to Unitholders in accordance with the distribution policy of the REIT.

**Calculation of Distributable Income**
**for the year ended December 31, 1999**

(In thousands of dollars)

| | 1999 | 1998 |
|---|---|---|
| Net earnings | $ 48,259 | $ 34,059 |
| Add (deduct) | | |
| Depreciation | 5,212 | 3,817 |
| Accrued rent | (1,860) | (2,138) |
| Imputed mortgage interest | 65 | 202 |
| Distributable income | $ 51,676 | $ 35,940 |

Accrued rent represents the adjustment made to normalize rents for certain tenants whose rental rate increases substantially over the term of their respective leases. This adjustment is required by Canadian generally accepted accounting principles and represents a non-cash item to be deducted in determining distributable income.

Total distributions per unit for 1999, which amounted to 89% of distributable income, were $1.104 per unit, compared to $1.03 in 1998. The tax-deferred portion of the distribution was 52% compared to 62% in 1998. This deferral will vary in any given year due to factors such as the size and timing of unit offerings and acquisitions of properties and provision of mezzanine financing for development projects.

# CHANGES IN FINANCIAL POSITION

## ASSETS

### Income Properties

The REIT acquired an interest in eight properties during the year and disposed of one. The acquisitions followed the REIT's investment strategy of acquiring quality assets occupied by long-term creditworthy tenants. These acquisitions impacted two of the REIT's property categories: single-tenant industrial and retail. A unit offering completed in July that raised $70.2 million provided funds for these purchases. Consequently, income properties increased by 17.4% to $687.4 million at December 31, 1999 from $585.3 million at December 31, 1998. Four of the properties were acquired as regular acquisitions while the other four were a result of the development program.

In February 1999, the REIT purchased two single-tenant industrial properties, one in Québec and one in Ontario. The Québec property consisted of a 742,000 square foot property in Montreal leased to Consumers Packaging for 15 years, while the second property comprised a 164,000 square foot property in Mississauga leased to Servi-Logistix for a 20-year period.

In the summer of 1999, the REIT purchased another two single-tenant industrial properties in Boucherville, Québec. The first was the 140,000 square foot office and warehouse building, located on a 15-acre site and leased to Corporate Express for a 15-year term with contractual rent escalations throughout the term. The second was a recently completed 729,000 square foot industrial distribution warehouse, located on a 52.8 acre site and leased to Rona Inc. under a 20-year term also with contractual rent escalations throughout the term.

In 1999, the REIT also exercised options to acquire four properties for which the REIT had previously provided mezzanine financing.

First, in February 1999, the REIT exercised its option to acquire a 69,000 square foot single-tenant industrial property in Mississauga, Ontario leased to Winston Steel for a 15-year period.

Second, in November 1999, the REIT exercised its option to acquire a 100% interest in two state-of-the-art distribution facilities in Mississauga, Ontario totaling 475,000 square feet.

Finally, in December 1999, the REIT exercised its option to acquire a 50% interest in the initial two phases of the Shawnessy Towne Centre development project in Calgary. The project is a 66.4 acre retail centre that will comprise 295,000 square feet on completion and includes Business Depot, Michael's and Future Shop as tenants.

## Mortgages Receivables

During 1999, the REIT continued to provide mezzanine financing for development projects that are consistent with the REIT's objectives and philosophy. These projects are secured through mortgage financing provided by the REIT, which receives or anticipates receiving an option to acquire an equity interest in the project. Construction financing will only be provided once 70% of the project has been pre-leased. Participation in development projects enables the REIT to acquire high-quality properties at higher yields than would otherwise be available.

Mortgages receivable increased 51.8% from eight developments comprising $153.1 million at December 31, 1998 to 12 developments comprising $232.5 million at December 31, 1999.

The largest of these transactions remains the mezzanine financing for TransCanada PipeLines' new head office in Calgary, Alberta. Related to this financing was the announcement, in October 1999, that H&R Developments Corporation had arranged for a $220 million, 22-year, first mortgage bond financing for this Class A office building. The building is expected to be complete by June 2001 at a total cost of $260.0 million.

Other significant transactions in 1999 include the following:

In July 1999, the REIT announced the provision of up to $28 million of financing for the construction of 11 design-build facilities leased for 20 years to Purolator Courier. The total land to be acquired will be 75 acres with the total building comprising 941,000 square feet.

Also in July 1999, the REIT provided $7.2 million to finance the development of a 162,000 square foot single-tenant industrial property in Mississauga, Ontario leased to PALEX Inc. for a 15-year term.

During August 1999, the REIT provided $8 million for a prime development site at the corner of Front and John Streets in downtown Toronto, adjacent to H&R REIT's property at 310-320-330 Front Street West. As development opportunities are examined, the REIT will earn a 9% return on the project while it continues to operate as a parking concession .

Finally in October 1999, the REIT announced that it would provide up to $35.0 million in mezzanine financing for the development of a 465,000 square foot office complex in Mississauga, Ontario, fully leased to Bell Mobility for a term of 18 years. The total cost of the project is expected to be $110 million. There are a further 30 acres available for development on an adjacent site.

In addition, the REIT continued to fund six other retail and single-tenant industrial projects, most of which will convert into revenue producing properties during 2000 and 2001 once our options are exercised. During 1999, four projects were converted into income producing assets of the REIT under this program.

### Other Assets

Accounts receivable decreased from $5.9 million at December 31, 1998 to $3.4 million at December 31, 1999 and deferred expenses increased from $5.0 million to $8.2 million over the same period. Accrued rent receivable increased by $1.9 million from $4.3 million at December 31, 1998 to $6.2 million at December 31, 1999 while prepaid expenses and sundry assets decreased from $2.8 million to $1.7 million over the same period.

Certain leases call for rental payments that increase significantly over their term. Accrued rent receivable records the rental revenue from these leases on a straight-line basis, resulting in accruals for rent that are not billable or due until future years. Accrued rent for 1999 represents the adjustment for $1.9 million of rent from the Nestlé lease at our 25 Sheppard Avenue West office building. This accrual has increased accrued rent receivable from $4.3 million at December 31, 1998 to $6.2 million at December 31, 1999, and will continue increasing until 2004 when the balance will begin decreasing until it reaches zero at the lease's maturity in 2019. Each annual adjustment to this item affecting the income statement will be removed from the calculation of distributable income each year as it does not represent a cash item.

## LIABILITIES

The REIT's Declaration of Trust limits the indebtedness of the Trust to a maximum of 60% of the Gross Book Value of the REIT (Gross Book Value is defined as the book value of the REIT's assets plus accumulated depreciation). At December 31, 1999, the REIT's indebtedness was 48% of the Gross Book Value of the REIT compared to 45% at December 31, 1998.

Mortgages payable increased to $358.4 million at December 31, 1999 compared to $284.3 million at December 31, 1998. The mortgages bear interest at the weighted average rate of 8.4% per annum (1998 – 8.9%) and mature between 2000 and 2018. To reduce risk, management has attempted to closely match the weighted average term to maturity of the mortgages of 9.4 years to the remaining average lease term of 10.1 years. Going forward, management anticipates the REIT will be able to renew its debt as it matures. Future principal payments as a percentage of Mortgages payable are as follows:

| | |
|---|---|
| 2000 | 4.4% |
| 2001 | 14.1% |
| 2002 | 4.8% |
| 2003 | 2.8% |
| 2004 | 6.8% |
| Thereafter | 67.1% |

Year-end debt included bank indebtedness of $95.5 million (1998 – $59 million), which bears interest at rates approximating the prime rate of a Canadian chartered bank. This debt is secured by fixed charges over certain income properties and is due on demand.

## UNITHOLDERS' EQUITY

In 1999, the REIT issued 6,325,000 units for gross proceeds of $70,207,500. The successful unit offering allowed the REIT to add to its portfolio of assets using equity rather than debt. As a result, the percentage of debt to Gross Book Value of assets was, as described above, substantially below the REIT's maximum allowable level of indebtedness. This provides considerable debt capacity to fund future acquisitions.

## LIQUIDITY & CAPITAL RESOURCES

During 1999, the REIT used a combination of new equity, conventional real estate debt, short-term financing and stable cash flow from its income producing properties to meet all of its liquidity requirements. Management expects to be able to meet all of the REIT's ongoing obligations and to finance future growth in a similar fashion.

## RISKS AND UNCERTAINTIES

The REIT has been structured to ensure that mandated investment guidelines and operating criteria are strictly adhered to. These policies govern such matters as the type and location of properties that the REIT can acquire, the maximum leverage allowed and the requirements for insurance coverage as well as environmental policies.

The REIT has maintained its ability to properly manage both operational and financial risks. The REIT's properties are leased under long-term arrangements to a diversified base of creditworthy tenants with strong covenants and are financed with long-term fixed rate mortgages.

No single tenant is critical to the REIT's ability to meet its financial obligations. The REIT's large, diverse tenant base allows it to fulfill its primary goal of maintaining a predictable cash flow.

Risk is further minimized through the maintenance of a low vacancy rate, relatively few short to medium-term lease renewals and a total debt restriction of 60% of aggregate assets. Furthermore, the REIT minimizes the interest rate risk by obtaining long-term fixed rate debt to replace short-term floating rate borrowings, with the weighted average term to maturity of long-term debt closely matching the remaining average lease terms.

To date, no material year 2000 problems have been detected in the operations of the REIT; however, no assurance can be given that the REIT will not detect any material year 2000 problems in the future although the probability of encountering such problems will be reduced over time. The REIT will continue to diligently monitor the situation in the foreseeable future.

# MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

The accompanying consolidated financial statements and information included in this Annual Report have been prepared by the management of H&R Real Estate Investment Trust which is responsible for their consistency, integrity and objectivity. The Trust maintains appropriate systems of internal control, policies and procedures to ensure that its reporting practices and accounting and administrative procedures are consistent, efficient and of a high quality.

KPMG LLP, the independent auditor, is responsible for auditing the consolidated financial statements and giving an opinion thereon.

The consolidated financial statements have been reviewed and approved by the Board of Trustees and the Audit Committee. This Committee meets regularly with management and the auditors who have full and free access to the Committee.

Thomas J. Hofstedter
President and Chief Executive Officer

Eric Cohen
Chief Financial Officer

# AUDITORS' REPORT

## TO THE UNITHOLDERS OF H&R REAL ESTATE INVESTMENT TRUST

We have audited the balance sheets of H&R Real Estate Investment Trust as at December 31, 1999 and 1998 and the statements of earnings, Unitholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Trust's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Trust as at December 31, 1999 and 1998 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP

Chartered Accountants
Toronto, Canada
January 28, 2000

# BALANCE SHEETS

(In thousands of dollars)

December 31, 1999 and 1998

| | 1999 | 1998 |
|---|---|---|
| **ASSETS** | | |
| Income properties (note 2) | $ 687,403 | $ 585,297 |
| Mortgages receivable (note 3) | 232,473 | 153,109 |
| Other assets (note 4) | 21,567 | 18,437 |
| | $ 941,443 | $ 756,843 |
| **LIABILITIES AND UNITHOLDERS' EQUITY** | | |
| Liabilities | | |
| Mortgages payable (note 6) | $ 358,422 | $ 284,255 |
| Bank indebtedness (note 7) | 95,478 | 59,004 |
| Accounts payable | 20,920 | 16,361 |
| | 474,820 | 359,620 |
| Unitholders' equity | | |
| 45,293,649 units (1998 – 38,968,649) (note 8) | 466,623 | 397,223 |
| Contingency (note 16) | | |
| | $ 941,443 | $ 756,843 |

See accompanying notes to financial statements.

Approved by the Trustees

Edward Gilbert
Trustee

Ronald C. Rutman
Trustee

# STATEMENTS OF EARNINGS AND UNITHOLDERS' EQUITY

## STATEMENTS OF EARNINGS

(In thousands of dollars, except per unit amounts)

Years ended December 31, 1999 and 1998

| | 1999 | 1998 |
|---|---|---|
| Operating revenue | | |
| Rentals from income properties | $ 115,882 | $ 93,432 |
| Mortgage interest income and other | 20,209 | 8,129 |
| | 136,091 | 101,561 |
| Operating expenses | | |
| Property operating costs | 47,028 | 38,141 |
| Mortgage and other interest (note 15) | 31,333 | 21,939 |
| Depreciation of income properties | 5,212 | 3,817 |
| Amortization of deferred expenses | 1,116 | 458 |
| | 84,689 | 64,355 |
| Operating income from income properties | 51,402 | 37,206 |
| Trust expenses | 3,143 | 3,147 |
| Net earnings | $ 48,259 | $ 34,059 |
| Net earnings per unit (note 9) | $ 1.16 | $ 1.09 |

See accompanying notes to financial statements.

## UNITHOLDERS' EQUITY

(In thousands of dollars)

Years ended December 31, 1999 and 1998

| | 1999 | 1998 |
|---|---|---|
| Unitholders' equity, beginning of year | $ 397,223 | $ 254,785 |
| Proceeds of offering of units | 70,208 | 147,380 |
| Issue costs | (3,136) | (6,759) |
| Net earnings | 48,259 | 34,059 |
| Distributions to Unitholders | (45,931) | (32,242) |
| Unitholders' equity, end of year | $ 466,623 | $ 397,223 |

See accompanying notes to financial statements.

# STATEMENTS OF CASH FLOWS

(In thousands of dollars)

Years ended December 31, 1999 and 1998

| | 1999 | 1998 |
|---|---|---|
| Cash provided by (used in) | | |
| Operations | | |
| Net earnings | $ 48,259 | $ 34,059 |
| Items not affecting cash | | |
| Depreciation and amortization | 6,328 | 4,275 |
| Gain on sale of income property | (499) | (365) |
| | 54,088 | 37,969 |
| Change in other operating items (note 10) | 2,018 | (5,980) |
| | 56,106 | 31,989 |
| Financing | | |
| Bank indebtedness | 36,474 | 59,004 |
| Mortgages payable | | |
| Acquisitions | 66,290 | 94,825 |
| Repayments | (17,950) | (20,719) |
| Proceeds of offering of units, net | 67,072 | 140,621 |
| Distributions to Unitholders | (45,931) | (32,242) |
| | 105,955 | 241,489 |
| Investments | | |
| Income properties | | |
| Proceeds on disposition | 1,400 | 1,650 |
| Acquisitions | (82,392) | (128,619) |
| Mortgages receivable | (79,364) | (144,809) |
| | (160,356) | (271,778) |
| Increase in cash | 1,705 | 1,700 |
| Cash (bank overdraft), beginning of year | 475 | (1,225) |
| Cash, end of year | $ 2,180 | $ 475 |
| Supplementary information: | | |
| Interest income received | $ 12,297 | $ 3,657 |
| Interest expense paid | 29,520 | 21,603 |
| Acquisitions of income properties through assumption of mortgages payable | $ 25,827 | $ 21,240 |

See accompanying notes to financial statements.

(In thousands of dollars, except per unit and unit amounts)

Years ended December 31, 1999 and 1998.

The Trust is an unincorporated trust with each Unitholder participating pro rata in distributions of income and, in the event of termination of the Trust, participating pro rata in the net assets remaining after satisfaction of all liabilities.

## 1. Significant accounting policies

The financial statements have been prepared in accordance with Canadian generally accepted accounting principles in all material respects and reflect the following policies:

### (a) Income properties

Income properties are recorded at the lower of cost less accumulated depreciation and net recoverable amount. Depreciation of buildings is recorded on the 5% sinking fund basis to fully amortize the cost of buildings over 40 years.

### (b) Deferred expenses

Leasing costs, such as commissions, free rent and other tenant inducements, are deferred and amortized on a straight-line basis over the term of the related leases. Mortgage financing costs are deferred and amortized over the terms of the related debt.

### (c) Accrued rent receivable

Certain leases call for rental payments that vary significantly over their term. The Trust records the rental revenues from these leases on a straight-line basis, resulting in accruals for rent that is not billable or due until future years. These amounts are recorded as accrued rent receivable.

### (d) Co-ownerships

The Trust carries out a significant portion of its activities through co-ownership agreements and records its proportionate share of assets, liabilities, revenues, expenses and cash flows of all co-ownerships in which it participates.

### (e) Income taxes

Pursuant to the terms of the Trust Agreement, the Trust intends to distribute its income for income tax purposes each year to such an extent that it will not be liable for income tax under Part I of the Income Tax Act (Canada). Therefore, no provision for income taxes is required.

### (f) Unit option plan

The Trust has an option plan available for officers, employees and certain trustees as disclosed in note 8. No compensation expense is recorded at the time the options are issued. Any consideration paid by option-holders on exercise of unit options will be credited to Unitholders' equity.

### (g) Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the year. Actual results could differ from those estimates.

### 9. Per unit amounts

Net earnings per unit, distributable income per unit and cash distributions per unit have been computed by dividing the respective amounts by the weighted average number of units outstanding during the year of 41,637,279 units (1998 – 31,305,938).

### 10. Change in other operating items

| | 1999 | 1998 |
|---|---|---|
| Accounts receivable | $ 2,547 | $ (5,012) |
| Accrued rent receivable | (1,860) | (2,138) |
| Deferred expenses | (4,336) | (3,390) |
| Prepaid expenses and sundry assets | 1,108 | (1,247) |
| Accounts payable | 4,559 | 5,807 |
| | $ 2,018 | $ (5,980) |

### 11. Risk management and fair value of financial assets and financial liabilities

(a) Risk management

The Trust is exposed to interest rate risk on its borrowings. It minimizes this risk by restricting total debt to 60% of aggregate assets and by obtaining long-term fixed rate debt to replace short-term floating rate borrowings. In addition, the weighted average term to maturity of long-term debt is closely matched to the remaining average lease terms.

The Trust is exposed to credit risk as an owner of real estate in that tenants may become unable to pay the contracted rents. Management mitigates this risk by carrying out appropriate credit checks and related due diligence on the significant tenants. Management has diversified the Trust's holdings so that it owns several categories of properties (office, industrial and retail) and is now acquiring properties outside of Ontario. In addition, management ensures that no tenant or related group of tenants accounts for a significant portion of the cash flow.

The Trust is also exposed to credit risk as a lender on the security of real estate in the event that a borrower is unable to make the contracted payments. Such risk is mitigated through credit checks and related due diligence of the borrowers and through careful evaluation of the worth of the underlying assets.

(b) Fair values

The fair values of the Trust's accounts receivable and sundry assets, bank indebtedness and accounts payable approximate their carrying amounts due to the relatively short periods to maturity of the instruments.

The fair value of the mortgages receivable approximates carrying value since interest rates have not changed significantly since the mortgages were negotiated.

The fair value of the mortgages payable has been determined by discounting the cash flows of these financial obligations using year end market rates for debt of similar terms. Based on these assumptions, the fair value of mortgages payable at December 31, 1999 has been estimated at $360,110 (1998 – $292,402) compared with the carrying value of $358,422 (1998 – $284,255).

## 12. Co-ownership activities

These financial statements include the Trust's proportionate share of assets, liabilities, revenues, expenses and cash flows as follows:

| | 1999 | 1998 |
|---|---|---|
| Assets | $ 333,099 | $ 314,242 |
| Liabilities | 188,977 | 176,371 |
| Revenues | 71,726 | 66,360 |
| Expenses | 49,860 | 47,003 |
| Operating income from income properties | 21,866 | 19,357 |
| Cash flows generated by operating activities | 20,934 | 21,291 |
| Cash flows provided by financing activities | 12,485 | 12,443 |
| Cash flows used in investing activities | (8,636) | (24,552) |

Under the terms of the co-ownership agreements, the Trust is only responsible for its proportionate share of the obligations of the co-ownerships.

## 13. Distributable income

Distributable income has been calculated in accordance with the terms of the Declaration of Trust as follows:

| | 1999 | 1998 |
|---|---|---|
| Net earnings | $ 48,259 | $ 34,059 |
| Depreciation | 5,212 | 3,817 |
| Accrued rent | (1,860) | (2,138) |
| Imputed mortgage interest | 65 | 202 |
| | $ 51,676 | $ 35,940 |
| Distributable income per unit (note 9) | $ 1.24 | $ 1.15 |
| Cash distributions per unit (note 9) | $ 1.10 | $ 1.03 |

## 14. Related party transactions

The Trust has entered into agreements with H&R Property Management Ltd. (the "Property Manager"), a company affiliated with H&R Developments (note 8), to provide property management services concerning the properties owned by the Trust and support services in connection with the acquisition and development activities of the Trust. The initial term expires in December 2001. As of January 1, 2000, a new agreement was signed to replace the existing contract. This new agreement is for five years with three automatic five year extensions and covers the same property management and support services. During the year, the Trust paid fees pursuant to these agreements of $4,416 (1998 – $3,686), of which $1,446 (1998 – $932) were capitalized to the cost of the income properties acquired.

The Trust has a mortgage payable to Batise Investments Ltd., an owner of H&R Developments, in the amount of $11,150 (1998 – $15,300). The related mortgage interest expense was $1,113 (1998 – $1,110).

The Trust entered into a mortgage receivable agreement with H&R Development Corporation, an affiliate of H&R Developments, to provide financing for the development of the TransCanada PipeLines Ltd. head office building. Pursuant to this agreement, the Trust has advanced $43,139 (1998 – $65,000). The related interest income was $6,347 (1998 – $2,010).





## 15. Mortgage and other interest expense

| | 1999 | 1998 |
|---|---|---|
| Mortgage interest | $ 26,525 | $ 18,784 |
| Interest on bank indebtedness | 4,808 | 3,155 |
| | $ 31,333 | $ 21,939 |

## 16. Uncertainty due to the Year 2000 Issue

The Year 2000 Issue arises because many computerized systems use two digits rather than four to identify a year. Date-sensitive systems may recognize the year 2000 as 1900 or some other date, resulting in errors when information using year 2000 dates is processed. In addition, similar problems may arise in some systems which use certain dates in 1999 to represent something other than a date. The effects of the Year 2000 Issue may be experienced before, on, or after January 1, 2000, and, if not addressed, the impact on operations and financial reporting may range from minor errors to significant systems failure which could affect an entity's ability to conduct normal business operations. It is not possible to be certain that all aspects of the Year 2000 Issue affecting the Trust, including those related to the efforts of tenants, suppliers, or other third parties, will be fully resolved.

# TRUSTEES AND OFFICERS



## UNITHOLDER INFORMATION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e-mail: info@hr-reit.com
Web site: www.hr-reit.com


**Registrar and Transfer Agent**
CIBC Mellon Trust Company
P.O. Box 7010
Adelaide Street Postal Station
Toronto, Ontario, Canada M5C 2W9
Telephone: (416) 643-5500 or 1-800-387-5501
Fax: (416) 643-5501
e-mail: inquiries@cibcmellon.ca
Web site: www.cibcmellon.ca

**Auditors**
KPMG

**Legal Counsel**
Fraser Milner

**Investor Information**
Analysts, Unitholders and others seeking financial data should contact: Eric Cohen, Chief Financial Officer at (416) 635-7520.

**Taxability of Distributions**
52% of the distributions made by the REIT to Unitholders during 1999 were tax deferred. Management estimates that 50% of the distributions to be made by the REIT in 2000 will be tax deferred.

**Plan Eligibility**
RRSP RRIF DPSP

**Stock Exchange Listing**
Units of H&R REIT are listed on the Toronto Stock Exchange under the trading symbol 'HR.UN'.

REIT